Therefore, it is highly unlikely, if not impossible, that LECs could successfully price low enough, and sustain these prices for the period of time that it would take to drive their competitors from the market, especially considering the number and size of their competitors.

The anti-discrimination provisions of Section 202 of the Act and the Commission's statutory responsibility to ensure just and reasonable rates would not simply disappear with the adoption of baseline pricing flexibility measures. Tariff filings proposing new services, as well as discount pricing plans, would be subject to both cost support and filing notice requirements. The Notice of Intent ("NOI") to file process proposed by GTE would provide an opportunity for the Commission and interested parties to review any LEC new service proposal, prior to the tariff filing, to identify any possible discrimination. The Commission would continue to exercise its authority to defer, suspend or reject any proposal that discriminates in favor of any one carrier or customer.[24]

Finally, many commenters cite the overall levels of existing access charges and the need to eliminate the subsidies inherent in certain access elements prior to adopting any changes to baseline price cap regulations. For example, MCI (at 1) argues that no additional flexibility should be granted until all price levels are driven to "economic costs." Similarly, citing the uneconomic pricing of CCL and RIC elements,

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24 Many of the concerns regarding potential discriminatory behavior are levied against a LEC's potential entry into the interLATA long distance markets via an affiliated carrier. However, LECs would continue to be subject to the Commission's rules regarding affiliate transactions, accounting procedures and the requirement to provide services, on a non-discriminatory basis, to an affiliate under tariff.

CompTel (at 5-9) complains that these rates are excessive and that any additional flexibility would only "exacerbate the effects of above-cost access charges on competition and consumers." Sprint (at 5) also agrees that LECs charge interstate rates higher than economic costs, however, Sprint recognizes that the current system causes IXCs to respond to artificial incentives and engage in service and facilities bypass. Accordingly, Sprint calls for a phase-out of the CCL and RIC elements, as do many other commenters.

C. Changes to baseline price cap regulation can and should be considered separately from comprehensive access reform.

GTE has repeatedly urged the Commission to initiate a comprehensive proceeding to reform its current access charge rules. The Commission could take action in such a proceeding to allow a larger proportion of common line costs to be recovered through end-user charges; this would reduce the amount of implicit universal service support generated by interstate switched access charges. GTE and many other parties have also proposed a proceeding to establish a new national universal service policy. Any new funding derived from a new universal service support mechanism would be used to reduce rates which provide implicit support today, including interstate access.[25]

In its proposals for access reform, GTE has also recommended changes in the access charge rules to ease the introduction of new services, to permit the offering of

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25 Sprint's proposal to apply a portion of the price cap productivity offset to reductions in the RIC element deserves serious attention. GTE believes this proposal could be used as a "starting point" for the Commission's expected access reform proceeding.

efficient optional discount plans, to simplify the price cap structure, and to establish an adaptive framework based on competitive criteria. The Commission has chosen to address these issues in the current *SFNPRM*, while deferring consideration of broader access structure issues to a subsequent access reform proceeding. The *SFNPRM* proposals, with the modifications GTE has suggested, have substantial merit, can be considered separately from the rest of the access reform issues, and should be adopted now.

The suggestion by commenters that the level of access charges precludes the adoption of the baseline changes is simply incorrect. When a group of services must recover a high level of contribution above its economic cost, the efficiency of the price structure becomes more, rather than less important. Nonlinear rates, such as volume discounted APPs for example, allow for the recovery of a necessary level of contribution, while permitting rates at the margin to be brought closer to economic cost. Such rates would therefore minimize the economic distortion associated with the need to generate a given amount of implicit universal service support. The presence of implicit support in today's rates is therefore not a reason to delay the adoption of more efficient pricing approaches.

The statement by ALTS (at 9) that no rate reductions can be considered to be beneficial in today's environment makes absolutely no sense, from either an economic perspective or a public interest standpoint. As a major purchaser of telecommunications services, GSA (at 5) recognizes that "this increased flexibility has a dual advantage. It allows carriers to set prices closer to the corresponding levels of cost, and it provides ratepayers with greater options in the manner in which they buy services."

The Commission has recognized these basic assumptions in granting AT&T relief for new services. The Commission adopted reforms for AT&T, even before adopting a price cap plan for AT&T. The Commission did this in markets where it assumed that AT&T still retained market power; and before any AT&T market had been found competitive through the application of criteria like those proposed in this *Second Notice*. The Commission took these steps because optional calling plans and customer-specific tariffs provided direct benefits to consumers.

Objections to adopting baseline pricing flexibility proposals until the Commission completes a comprehensive access reform proceeding constitute nothing more than a delay tactic.[26] The Commission has already recognized that a certain level of reform is needed now. Rapid technology changes and market dynamics are creating competition today. GTE believes Commission regulations should be adapted so as to foster development of new and better services, ensure lower prices and reduce regulatory burdens. Tariff and pricing flexibility changes as proposed by GTE will improve the efficiency of baseline regulation, regardless of the presence or extent of competition. As GTE has previously stated, price caps are intended to replicate the outcome of a competitive market, even where the market is not yet competitive. The proposed

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26 In the same vein, AT&T (at 2) and other parties (Time Warner at 6, n.5) have suggested that the proposals set forth in the *SFNPRM* somehow represent a reversal of the Commission's findings in the First Report and Order. This argument is specious since the Commission clearly intended its actions in the First Report and Order to be interim in nature. As the *SFNPRM* explains (at ¶17), "In the First Report and Order, although we acknowledged the emergence of competition in a number of segments of the LECs' markets, we generally found that the record before us was insufficient on these issues, and we decided to defer them until this Second Further Notice."

changes would allow baseline regulation to better achieve this goal. Delay in reforming the baseline LEC price cap regulation will only exacerbate inefficiencies that are inherent in existing access prices and service offerings today. GTE urges the Commission to move forward with its "pro-competitive agenda" and adopt change in baseline price cap regulation without regard to the actual level of competition present.

D. No competitive "checklist" should be adopted as a precondition for changes in baseline regulation.

A number of parties seek to tie the adoption of any potential reforms in the Commission's interstate access and tariff filing rules to "checklists" related to the removal of supposed barriers to entry into local service markets. These commenters, who are mainly competitors of the LECs, wish to delay the advent of full and equitable competition in access markets, and attempt to use this proceeding to further their objectives in other markets. The Commission should not condition its proposed changes to baseline price cap regulation on any competitive "checklist."

First, the Commission should adopt the proposed baseline changes because they are good for consumers, even in markets which have not yet been shown to be competitive. Therefore, no measure of competition -- however imperfect -- should be set as a precondition for these changes.

Second, the checklist items proposed by various parties are long and quite diverse. Commenters advancing these lists do not explain the relationship between the regulation of local competition at the state level, and LEC market power in the provision of interstate access services.

Third, many of the "checklist" parties effectively abandon any attempt to identify the relevance of their lists to reform of baseline regulation. Instead, they focus on "a potential 'carrot and stick' approach which would link LEC regulatory freedom to LEC success in removing entry barriers...." (ALTS at 12.) In effect, the Commission is being asked to use its own regulation of interstate access as a lever to advance the agendas of certain parties in matters currently at issue before state regulatory agencies. This is not an appropriate use of the Commission's interstate access regulation. If the proposed baseline changes will produce benefits for consumers of interstate access, the Commission should adopt them, and should not hold customers hostage to decisions in state jurisdictions concerning local services.

The issues surrounding local competition are currently being debated before regulators in many states. As these proceedings are resolved, GTE is confident that local competition will continue to grow.[27] However, the issues are complex, and the specific facts vary from state to state. Each of the parties in these proceedings has taken positions based on its own self-interest, and these in turn are reflected in the different proposed "checklists." The Commission should not take sides in this debate, or assume that using its access regulation as a "stick" will improve the outcome.

Instead, the Commission should determine whether any of the "checklist" items has relevance as part of the criteria the Commission establishes for the administration of streamlining. GTE will discuss this issue *infra* in connection with streamlined regulation.

IV. SPECIFIC CHANGES TO BASELINE PRICE CAP REGULATION WILL WORK TO ACHIEVE THE COMMISSION'S STATED GOALS.

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27 In fact, GTE has recently filed for certification in California to act as an alternative local service provider outside its own existing serving areas.

LECs should be allowed greater flexibility to file tariffs for new services, to implement zone pricing for all access elements, to be permitted to lower access rates and to implement cost-based APPs to respond to similar competitive price offerings, *without* regard to the level of competition. Generally, commenters such as GSA and Sprint agree with these proposals. Additionally, GTE believes the price cap baskets should be restructured and LECs should be allowed to respond to large customer demands by filing ICB or RFP-type tariffs.

As stated *supra*, competitors such as AT&T, MCI, Time-Warner, MFS, Teleport and NCTA advocate the retention of existing restrictions on LEC access service development and pricing. However, to the extent that the Commission adopts certain baseline reforms, many of these commenters propose additional burdens which, in some respects, are more onerous that the existing price cap rules. GTE will address each of these concerns in response to commenters objections of the following specific proposals set forth in the *SFNPRM.*

A. Part 69 Waivers

Recognizing that its Part 69 rules represent an impediment to the introduction of new services and rate structures, the Commission has proposed to simplify the process by which it approves LEC waivers of the Part 69 rules to establish new switched access rate elements. An alternative to the existing waiver process is essential to allow LECs to proceed with the filing of a new services tariff with minimal delay and uncertainty. The proposal set forth in the *SFNPRM* is an improvement in that it replaces the criteria established generally for waivers with a more relevant public interest standard. However, it still would require the LEC to file a petition, does not specify a time period for the Commission to respond, and leaves the burden of proof that the service is in the public interest to the LEC.

GTE has proposed that Part 69 should be modified to replace the current waiver process for new services. The LEC would instead file a Notice of Intent ("NOI") to file, which would sufficiently describe the new service and proposed rate elements and applications. The proposed service would be presumed to be in the public interest, and the Commission would have a limited time to act in response to the NOI.[28] The resulting process would finally make the Commission's procedure for review of new services consistent with the provisions of the Communications Act, which establishes a presumption in favor of new services, and places the burden on any party opposing a new service to show why it is not in the public interest.[29]

Several commenters, such as LDDS (at 32) and NCTA (at 27), oppose the Commission's efforts to relax the over-rigid waiver process, and instead argue that Commission must first reform access rules. Again, this is a delaying tactic. These commenters are well aware that an access reform proceeding could take months or years to complete. GTE agrees the Commission should proceed with such needed reform. GTE has consistently recommended reform of the Part 69 structure itself as the best way to improve the introduction of new services. However, GTE urges the Commission to adopt the proposed relief now. A more streamlined approach reasonably balances the need for LECs to introduce new services on a timely basis

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28 GTE also strongly supports the *SFNPRM* proposal to permit other LECs to file similar services on a "me-too" basis.

29 47 U.S.C. §157.

while ensuring that new service rate structures and applications are nondiscriminatory and reasonable.

AT&T (at 32-34) is opposed to revising the waiver process, stating that rules that discourage unreasonable discrimination and competitive impacts should be given precedence over any benefits from LECs departing from the Part 69 structure. Nothing in the procedure GTE has proposed would lead the Commission to allow the adoption of unreasonably discriminatory rates. Contrary to AT&T's contentions (at 34), proposals to simplify the Part 69 waiver process would not "run afoul of Court of Appeals admonition that FCC may not tolerate evisceration of the rule by waivers." The proposal in the *SFNPRM*, and GTE's modified proposal, would both amend Part 69, through this rulemaking, to incorporate the new procedure. The rules of procedure governing waiver requests, to which AT&T refers, would not then apply. In fact, streamlining the waiver procedure would create a process which was consistent with the Act, which the current waiver process is not. Further, neither the Commission nor GTE is advocating the elimination of public notification requirements and the opportunity to oppose new service proposals. The Commission can continue to use its discretion to find that a new service described in an NOI is not in the public interest, or to defer or reject any tariff filing. The Commission would also have the opportunity to open a proceeding to deal with any serious public interest concerns raised by a new service proposal. The NOI process proposed by GTE represents a means to simplify the existing process until the Commission completes a comprehensive reform of its Part 69 Rules, but in no way constitutes abandonment of the Commission's statutory responsibilities.

The Commission should readily dismiss those commenters' proposals which would further entangle both the LECs and Commission in an overly-intrusive regulatory process. Rather than proposing constructive alternatives to the existing waiver procedure, MCI (at 12) and Ad Hoc (at 17) propose even more stringent criteria and prescribed standard waiver formats, which would complicate the process rather than improve it. In addition, MCI offers no suggestion as to the time period in which the Commission should take to respond to a new service filing. Regulatory delays in acting on waivers is the primary reason the Commission has proposed to modify the process.[30] MCI claims that this delay is usually the result of LECs submitting too little information regarding their waiver request. This is simply not true. Waivers that GTE has filed have provided substantial documentation regarding service technologies and provision, operating practices and cost characteristics.[31]

In contrast, however, other commenters recognize the need for modifying the Part 69 waiver procedure, specifically to encourage the growth of new services.[32] Even Time Warner (at 18) observes that delays in granting waivers cause unfair uncertainty in the existing access marketplace and suggests that the Commission act on all waiver

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30 As stated in GTE's Comments (at 23, n. 29), GTE has experienced significant delays in obtaining any action on its waivers.

31 *See, e.g.*, GTE Telephone Operating Companies Petition for Waiver of Part 69 Rules to Geographically Deaverage Switched Access Services, November 27, 1995 (GTE "ZonePlus" Plan).

32 "Replacement of Part 69 waiver process with a public interest showing may be an effective means of expediting the introduction of new services." CompTel at 30-31. The Part 69 process "can and should be streamlined." Sprint at 20. Also, Ad Hoc (at 15-17) indicates that the public interest could be served by LECs making a public interest showing, subject to comment and notice periods.

petitions within a set period of time (120 days). Under the current framework, customers cannot anticipate when services could be made available and at what structure and price. Further, the expectation of delay, cost, and uncertainty in the current waiver process deters LECs from proposing services that would otherwise be worthwhile. A new procedure for handling waivers is essential to foster viable LEC participation as access markets become more competitive.

B. New Service Tariff Filings

In the *SFNPRM*, the Commission proposes to classify new services as either "Track 1" or "Track 2." Track 1 services would be subject to existing notice and cost support rules and Track 2 services would be subject to reduced requirements. This approach could represent an improvement over the current process, in that it could provide a means for affording increased scrutiny to services which have raised specific public policy concerns. However, the essential problem with the current process is that it requires each proposal to be classified, through a waiver process, prior to the tariff review.

GTE is concerned that a new approach which would require the Commission to classify every new service as either Track 1 or Track 2 would further complicate new service introductions and would lead to unnecessary disputes over how a service should be classified. Further, the process proposed in the *SFNPRM* places the burden of proof on the LEC to demonstrate that the service is in the public interest, contrary to the presumption in the Communications Act. Accordingly, GTE has proposed that any new service be presumed to be a Track 2 service, consistent with the Act, unless it has been found explicitly by the Commission through a prior proceeding to be a Track 1 offering.

Not surprisingly, several of the LECs' competitors oppose the Track 1/Track 2 proposal of the Commission, and insist instead that all services be considered as "Track 1".[33] This proposal places the interests of these competitors above those of customers to whose needs LECs must respond. Over the past several years, GTE has introduced numerous new switched and special access offerings which were developed as a direct result of customer demand.[34] Other offerings have been primarily technology driven such as the introduction of SS7 based services and SONET-based transport. Clearly, the positions of the CAPs, which oppose any relaxation of the new service tariff filing rules, are self-serving. It is to their benefit that existing regulation causes significant delay in the ability of LECs to deliver new services and capabilities that customers demand, and creates uncertainty concerning the LECs' ability to deliver the services at all. When services are delayed, LECs may be viewed as unresponsive to service requests, which could encourage customers to obtain such service functions from other providers who are not so burdened. As Schamalensee and Taylor observe (at 8), the existing process essentially places a form of asymmetric regulation on LECs, reducing their ability to market their services by varying product characteristics (including price) and determining the optimal product and price level for the market.

Some commenters opposing additional streamlining of new service introductions raise concerns that LEC new service filings submitted under Track 2 could potentially

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33 STV at 8, COMCAST at 24-25, CompTel at 26.

34 These include: Switched 56, Fractional T1, E1 Service (2.048 Mbps), Fiberconnect, DOVConnect, Business/Residence Line 800, Videoband Type II, Preferred Directory Assistance, Enhanced Access Diversity, DDS Bridging and Secondary Channel, and new 2.4, 4.8, 9.6, and 56 kbps DDS speeds.

be priced too high, while others are concerned that new service prices will be priced too low. For example, AT&T (at 23) agrees that the direct cost showing for a Track 2 service would guard against a LEC pricing a monopoly service too low, but expresses concern that a new service may be priced too high.

Similarly, MCI claims the Commission should provide explicit guidance on the level of overhead costs. For any prices which exceed direct costs, MCI (at 11) suggests that LECs should make a corresponding reduction in their PCI which, as MCI claims, is consistent with ratemaking practices followed under rate of return regulation. First, MCI has not adequately demonstrated that the current practice in which LECs apply standard uniform loadings has led to excessive rates. GTE is not aware that the Commission's objective in designing its price cap plan was to imitate rate-of-return regulation. Further, MCI's suggested adjustment to the PCI is inconsistent with the Commission's current approach to rolling new services into the PCI, which is designed to ensure that the new service does not influence the PCI or SBI calculations. Setting prices at some level above direct cost does not lead to "double-recovery of overheads" once it is incorporated in the calculation of the PCI. All rates will be designed to contribute toward recovery of the common overhead costs of the firm and, therefore, will be set at some level above direct cost. However, under the proposed Track 2 filing process, MCI could continue to challenge any proposed rates that it believes are set at an "excessive" level above direct cost. In addition, the existing PCI coupled with Service Band Index constraints, adequately protects against exorbitant increases in rates.

None of these commenters offer any evidence that new service offerings are deliberately priced in an excessive manner. As ICG (at 3) observes, "New services are usually offered within a particular market and compete against existing services within that market." As such, there is little incentive for LECs to load new service prices with excessive overhead costs.

In contrast, other parties claim that streamlined treatment of new service introductions will result in prices that are too low. For example, CCTA (at 23) claims LECs will tend to assign lower direct costs to Track 2 services. MFS (at 2-4) contends that LECs should support new services with a showing similar to that used for Expanded Interconnection Services, which are subject to standard rate of return pricing rules, and not price caps. These parties call for even more extensive cost support showings for new service tariff filings, and are over-reaching.

Under the process suggested in the *Second Notice*, all new service filings will be required to demonstrate that prices are set at levels that equal or exceed direct cost, thereby guarding against predation. In addition, requiring all new service prices to be set at levels that approximate full revenue requirement allocations, as MFS suggests, would ensure that LEC's new service introductions would never be able to adequately compete with those of competitors. While this may be exactly the result that MFS wishes the price cap rules would achieve, it clearly does not serve the public interest. Further, this proposal ignores the fact that the Commission adopted price caps, in part, because it recognized that fully-distributed cost allocation processes did not provide the Commission with useful information as to how relative rate levels should be set.

Some commenters also express concern that the 14-day notice period would not provide time for meaningful objection and review (AT&T at 24, CCTA at 24) or to determine if new service proposals are reasonable and non-discriminatory (LDDS at 31). Under a more streamlined approach, LECs will have no more ability to "exploit market power" than they do today. The Commission would continue to rely on the tariff review process to ensure just and reasonable rates; all service prices filed under a Track 2 scenario would need to demonstrate recovery of direct costs; the Commission would still have the ability to defer the effective date of any tariff, be it Track 1 or Track 2, to a total of 120 days; and the Commission could suspend and investigate tariff filings for up to five months. Under the proposal outlined in the *SFNPRM*, and the modification advanced by GTE, these abilities would not change.

Other parties generally recognize that some simplification of the tariff filing process may be warranted. For example, Time Warner (at 11) states that, if the Commission divides services into two categories, the proposal to establish "two tracks" is not without merit, as long as new service prices are set above direct cost. Sprint (at 14) recognizes the benefit of relaxed tariff filing rules for *all* new services by proposing that shorter notice periods (*i.e.*, 30 days) be adopted.

The Commission should proceed to streamline new service tariff introductions. Many new services are essentially new optional features brought about through technological innovation and market demand. These are already provided by CAPs in advance of LEC introductions, primarily because of regulatory delays in Part 69 and new service tariff process. Indeed, as MFS admits (at 3), "many of the new services introduced by LECs will be targeted for users with competitive service alternatives available to them." Simply put, customers will not be made worse off, and will gain new service options, as a result of the introduction of more flexible new service filing rules. Commenters have not demonstrated anything to the contrary.

C. Additional Pricing Flexibility

GTE supports the extension of zone density pricing to all other switched access elements in addition to its existing application for transport services. Zone pricing would allow prices to be aligned more closely with geographic differences in cost associated with density. In its recent petition seeking a waiver of the Part 69 rules to offer its ZonePlus service, GTE demonstrated that its costs for access services do in fact vary with differences in density. The recent record in the Commission's proceeding on the Universal Service Fund ("USF") also provides evidence that both loop and switching costs vary with density.

Sprint (at 3, 6) supports zone pricing for other switched access elements, including the CCL and Residual Interconnection Charge ("RIC"). As both the Commission and Sprint observe, allowing deaveraged CCL and end office switching elements will enable LECs "to target rate reductions to the customers who are most likely to bypass LEC switched services in favor of potentially less efficient services.[35] CompTel (at 38) also supports allowing LECs to vary rates geographically, "without regard to the existence of access competition."

GTE also agrees with Sprint and STV (at 8, n.22) that the existing thresholds at which carriers can implement volume and term discounts for switched access should be removed. This requirement is particularly problematic for GTE, whose study areas are generally smaller and less dense than those of other large LECs.[36] As Sprint observes

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35 Sprint at 13, *citing* NYNEX Telephone Company Petition for Waiver, Memorandum Opinion and Order, FCC 95-185, released May 4, 1995 at ¶56.

36 For a detailed discussion of this point, see GTE's Petition for Waiver of the 100 DS-1 threshold requirement. Petition for Waiver of the GTE Telephone Operating Companies, CC Docket No. 91-141, filed Jan. 6, 1995.

(at 12), "by removing the cross connect prerequisite to zone density pricing, the FCC will enable LECs to begin migrating rates towards cost which will eliminate uneconomic pricing umbrellas and will foster more vigorous competition, to the benefit of access providers, access customers and end users."

D. Alternative Pricing Plans (APPs)

In the *SFNPRM*, the Commission reaches the tentative conclusion that LECs should be allowed to establish alternative pricing plans, including both temporary promotional offerings and long-term discounted rate plans for switched access. GTE wholeheartedly agrees. LECs should be allowed to file temporary, promotional APPs, without cost support, to remain in effect not more than 90 days. These temporary offerings should not be included in price caps. Permanent APPs should be supported with a showing that rates exceed direct cost, and should then be incorporated into the calculation of the annual PCI adjustment in the next annual filing following the year in which they were introduced, in the same way that new services are today.[37]

Most commenters appear to support the introduction of APPs, provided adequate safeguards are in place to guard against predatory pricing and discrimination.[38] For example, MCI (at 12) states that "optional additional pricing plans,

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37 As access markets become more competitive, cost information becomes more proprietary. GTE suggests that LECs should be able to submit their cost showings for APPs under a protective arrangement. Forcing the LEC to reveal its cost floor to its rivals imposes an asymmetric handicap on the LEC, and by reducing a competitor's uncertainty concerning LEC pricing, could constitute an undesirable form of signaling which would discourage aggressive price competition.

38 CompTel at 28-30, MFS at 5, Time Warner at 14-16.

if competitively neutral from the perspective of the interexchange industry, ought to be permitted." Further, MCI agrees (at 13) with GTE that APPs should be rolled into price caps at the next annual filing, as are new services today.

Commenters opposing any flexibility in the introduction of APPs[39] cite the usual string of arguments against volume and term discounts that the Commission has previously addressed and rejected before in its Docket 91-141 proceedings. These include concerns of predatory pricing, the ability to "price squeeze," and potential harm to the development of competition. Others claim that if allowed, LEC APPs should be subject to stringent cost support requirements. As stated *supra*, concerns over predatory pricing and offsetting rate increases and decreases are unfounded.

Competitors would be protected against pricing too low by the requirement that the LEC demonstrate that the proposed APP rates exceed direct cost. Prices which meet this test cannot deter efficient entry. Ad Hoc (at 14) proposes that a LEC should provide the same cost support for an APP that it would for a below-band tariff filing. This is essentially the same as the direct cost showing GTE proposes.

Customers would be protected against too high prices by the continued availability of the existing service at a price capped rate.[40] The introduction of the APP would not create any "headroom" which would permit the LEC to raise the rate for the existing service -- or any other rate in that price cap basket. During the first year, the APP would be held out of price caps. At the next annual filing, the APP would be rolled

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39 CompTel at 28-30, Ad Hoc at 12-14, NCTA at 24-25.

40 *See SFNPRM* at 60.

in as new services are today. Under this procedure, the inclusion of the APP does not affect the year-over-year calculation of the PCI or the SBIs, and hence does not create any headroom under these indices.

The concern most often cited in opposition to LEC APP pricing is that APPs would be used to discriminate among different classes of customers, or that a LEC may use such offerings to provide an advantage to an affiliate providing long distance interLATA services. To the contrary, GTE has demonstrated in its recent ZonePlus proposal that such a plan can be developed in a "competitively neutral" manner which would benefit all IXCs, large or small.[41] The availability of the APP to all similarly situated customers, as well as the Commission's long-standing open resale policy, will guard against any unreasonable discrimination.[42] The Commission has adequate tools, through the tariff filing and complaint processes, to determine if potential discrimination could result from the filing of an APP tariff, including any attempt by a LEC to construct a plan that benefits only its affiliate.[43] Anti-discrimination rules and strict regulations regarding transactions with affiliates would help guard against any potential discriminatory actions.

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41 *See* GTE's ZonePlus Petition. GTE proposes a volume discount which would depend on the number of minutes which originate or terminate at a given end-user location. This structure ensures that any IXC, regardless of the carrier's size, can obtain the same discount from GTE to serve the same end user.

42 *See* Schmalensee and Taylor at 11 on the effect of resale in guarding against unreasonable discrimination.

43 The example cited by some parties of an APP designed so that only the LEC's affiliate could purchase it, is hardly a realistic concern. First, it is not clear what basis the LEC could find by which to distinguish its own affiliate from other large IXCs. Second, such a plan, if it were ever to succeed, would be too transparent to escape detection.

Sprint contends (at 17) that APPs are unnecessary if the Commission expands zone density pricing. While expansion of zone pricing is indeed crucial, APPs are very appropriate in the marketplace for exactly the same reasons Sprint supports zone pricing (*i.e.*. prevents uneconomic bypass, more efficient pricing, etc.). Zone pricing will enable LECs to move access rate elements towards their economic cost. Even with zone pricing, however, the LEC will still experience economies of scale within each geographic zone which will cause the incremental cost of service to be less than the average cost. By offering volume and term discount options, the LEC can bring the rate the customer pays at the margin closer to the economic cost of service than would be possible with a uniform rate within the zone. CAPs and other local competitors, unlike LECs, can deaverage their rates geographically.[44] Nonetheless, they use various discount offerings in order to compete directly with the LECs.

MCI suggests that, if allowed, APPs should be subject to a Part 69 waiver requirement. This is unnecessary. The essence of the APP proposal is that it provides a vehicle, short of a comprehensive access reform, for introducing attractive new service options, without imposing the barrier which the waiver process has represented for innovative proposals in the past. If a waiver requirement is imposed, the APP concept will lose its value. The tariff review process will provide ample opportunity for the Commission to review APPs for possible discrimination. As the present round of comments makes clear, the IXCs will be vigilant for any hint of discrimination, and will have an opportunity to intervene against any proposed tariff that violates Commission

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44 These carriers, of course, are also able to negotiate customer-specific contract tariffs, which LECs are not permitted to do.

policy.[45] Although the opponents argue discrimination, none of the commenters has explained what a LEC would have to gain by favoring one of its large customers over another.

Further, MCI opposes granting LECs the ability to file temporary promotional offerings, claiming that such offerings can easily be used to discriminate among customers. There is no evidence that such activity would occur. Indeed all the major IXCs, including MCI, have made extensive use of promotional plans, some of which are targeted to specific customer segments based on current market trends. As long as customers are allowed to retain the basic service offering and similarly situated customers are treated alike, targeting of promotions does not necessarily constitute discrimination. Here again, it would simply be impractical for a LEC to design a promotional offering that would favor one IXC, or its own affiliate. Such a design would be too transparent, and could hardly escape attention in the tariff review process. In addition, MCI cites concerns over giving immediate "credit" for promotional offerings in price cap calculations, which would increase the ability of the LEC to take advantage of greater headroom. To the contrary, promotions would not create headroom if the Commission adopts GTE's proposal that promotional offerings, limited to a specific time period, were kept entirely out of price caps.

AT&T (at 29) contends that LECs should not be allowed to introduce term and volume discounts for those elements in which subsidies are incorporated, such as the

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45 If the Commission believes that it needs an opportunity, outside the tariff review process, to examine APP proposals, then it should require LECs to file NOIs, as GTE has suggested for new services, rather than waiver petitions.

CCL and RIC. Again, GTE recognizes the urgent need to address current subsidy problems through action on access reform and universal service. However, the existence of such implicit support flows makes it all the more important that efficient pricing structures -- such as nonlinear prices -- be employed in order to minimize the efficiency losses caused by the need to recover this support through access charges.

AT&T (at 30) also argues against the adoption of any discount schemes for local switching, arguing that switching scale economies are minimal. However, evidence presented in the Commission's proceeding on the Universal Service Fund strongly suggests that scale economies in switching are significant. Certainly, AT&T has discounted its own switched service offerings for many years. In any event, the degree of scale economies will be reflected in the direct cost floor. If the economies are great, the floor will be low relative to the rate; if they are small, the floor will be closer to the average rate. Use of a cost floor will prevent LECs from gaining approval of discounts which are not justified.

The simple fact is that optional plans similar to APPs have been widely used in the industry by most telecommunications providers, and for almost every service -- except LEC switched access. The Commission adopted procedures in 1985 -- long before it found any of AT&T's long distance markets to be competitive -- which allowed AT&T to offer Optional Calling Plans ("OCPs") for its switched MTS service. In CC Docket No. 84-1235, the Commission considered how such OCPs should be regulated. The NPRM in that proceeding took note of "the increase in competitive market forces faced by AT&T." However, for the purposes of the OCP proceeding, the Commission did not find that competition was sufficient to constrain AT&T:

> In this docket we do not address the issue of whether AT&T continues to have substantial market power but assume arguendo that it does have

> sufficient dominance to justify regulatory scrutiny of its MTS offerings. Rather we focus narrowly on how the Commission can most effectively guard against unjust and unreasonable discrimination without unduly impeding strenuous price competition until this Commission reaches any different determination about AT&T's market power.[46]

In other words, the Commission considered changes to "baseline" regulation for AT&T which would allow it to price more efficiently, and respond to emerging competition, in the absence of a specific finding that AT&T's markets had yet become competitive. Faced with essentially the same question that the *SFNPRM* raises, the Commission chose to permit AT&T to offer APPs.

Then, as now, parties raised concerns with respect to discrimination and predation.[47] The Commission correctly identified the value of volume discount options:

> We are unpersuaded by MCI and TDX that multipart tariffs should not be permitted....The major thrust of this proceeding is to allow carriers flexibility in designing MTS packages to meet customers' varying demand characteristics. Prohibiting multipart pricing would greatly limit that flexibility. We do not adopt the requirement that all customers must be charged the same variable rate for the last unit of consumption because that restriction would not ensure against rates that were too high or too low. Moreover, this proposal would unduly restrict pricing flexibility while contributing nothing to our major concerns regarding predation and burdening other ratepayers.[48]

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46 Notice of Proposed Rulemaking, CC Docket 84-1235, Guidelines for Dominant Carriers' MTS Rates and Rate Structure Plans, 50 Fed. Reg. 1881, January 14, 1985 at ¶1. ("*OCP Notice*")

47 Interestingly, MCI proposed a FDC cost standard for OCPs, which the Commission rejected, finding that it would prevent AT&T from realizing the potential efficiency gains from OCPs.

48 Memorandum Opinion and Order, CC Docket No. 84-1235, FCC 85-540, 50 Fed. Reg. 1881, October 17, 1985 at ¶81. ("*OCP Order*").

The Commission's action in the *OCP Order* led to a wide array of new, optional pricing offerings from AT&T, including Reach-Out America, Pro-America and Pro-WATS, which in turn prompted responses from competitors, such as MCI's Friends and Family. Over the next few years, the Commission approved a series of other flexible pricing arrangements for AT&T, including Megacom, SDN and Tariff 12. All of this took place before AT&T's price cap plan began, before the Commission developed competitive criteria for AT&T's markets, and before the Commission found any of AT&T's markets to be competitive.

Customers have benefited from the availability of these attractive service options, and from the rivalry they have sparked in the long distance market. It is these nonlinear discount offerings, rather than across-the-board reductions in basic, uniform MTS rates, which have generated all of the benefits customers have received from long distance competition. With the exception of reductions ordered by the Commission to pass through access reductions, GTE is not aware of a single occasion since divestiture when AT&T has made a voluntary reduction in its basic MTS rates.[49]

Now the Commission seeks to repeat in access markets the success it has achieved with its pro-competitive policies in long distance markets. GTE submits that

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49 The Commission recognized in the *OCP Order* (at ¶61) that optional discount plans had been the primary vehicle for rate reductions in the interexchange market: "although basic rates have remained relatively high, AT&T passed on its savings from lower access charges in the form of optional calling plans and other discounts and promotions. We also have no doubt that AT&T's long distance competitors have been forced by competition to follow suit. Thus, although the data BellSouth offered to show that basic long distance rates have not decreased may be correct, that data fails to capture the effect of optional calling plans and other discounts."

the Commission should not begin by prohibiting the very pricing arrangements that have produced all of the benefits consumers have realized in the long distance market.

Tellingly, most of the parties opposing APPs, or supporting strict restrictions on their use, regularly offer volume and term discounts and promotional offerings. Indeed, discounts have been maintained for extended periods in most service markets. In the *OCP Order,* the Commission found the widespread availability and persistence of volume discounts to be evidence that they were reasonable for AT&T as well:

> To the extent that a dominant firm's rivals, firms which surely do not have market power, offer volume discount or other calling plans during a lengthy period of time, however, this may suggest that such plans are consistent with cost-justified pricing.[50]

E. Baskets

The Commission has requested comment on what revisions, if any, are needed to current price cap baskets and categories. For the most part, the LECs, including GTE, advocate a price cap plan incorporating five baskets: Switching, Transport, Common Line, Interexchange and Video Dialtone. The Switching Basket would include three separate categories: local switching, operator services and data base (LIDB and 800). In the Transport Basket, services would be grouped into four categories: analog, digital, interconnection and tandem switching. The Common Line category would retain the CCL and EUCL elements, with some modifications to allow zone pricing. Video Dialtone and Interexchange would remain unchanged from the existing structure.

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50 OCP Order at ¶45. The OCP Order (at n.34) goes on to explain: "The fact that a firm maintains its pricing plan over a lengthy period of time is strong evidence that its prices are at least equal to its costs."